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Cases, Regulations, and Statutes

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As a condition of the buy-back, the taxpayers entered into a shared appreciation agreement which required repayment on a formula basis if the property were conveyed within 10-years.[11] The recapture agreement commitment was secured by a secondary lien on the land. In the year of the buy-back, the Farm Service Agency of the U.S. Department of Agriculture (the successor to FmHA) issued a Form 1099-C showing "amount of debt cancelled" of $177,772.27.[12] The taxpayers did not report the amount as discharge of indebtedness on their income tax return in the year of the buy-back.

The key issue before the court was whether the recapture agreement continued the taxpayer's obligations to FmHA/FSA in a manner that there was no discharge of indebtedness in the year of the buy-back of collateral. As the court noted, the disagreement was over the contingency involved. The taxpayers argued that the cancellation itself was contingent, believing that the transaction merely generated an agreement to cancel their debt at a future time. On the other hand, IRS argued that the transaction involved a present cancellation with a contingent future obligation to pay.[13]

The Tax Court took the position that the taxpayer's indebtedness was discharged in the year of the buy-back of the collateral.[14] The court's reasoning was that "whether or when [the taxpayer] would ever be required to make any further payments to FmHA rested totally within their own control.[15] As the court explained, if the taxpayers chose to sell their property within 10-years, repayment would be required; if the taxpayers chose not to dispose of their property, nothing further would be due.[16]

In conclusion

The decision in *Jelle v. Comm'r*[17] is consistent with the IRS position taken in a letter dated May 22, 1989 from IRS to the Farmers Home Administration[18] In that letter, the Chief Counsel stated "…the Recapture Agreement is not a substitute indebtedness for any of the FmHA debt in excess of the buyout amount. Thus, an FmHA borrower realizes discharge of indebtedness income to the extent the old FmHA debt balance exceeds the buyout amount even when a Recapture Agreement is part of the restructuring arrangement…."[19]

The IRS position has been that the same result applies to a debt write down.[20] Although *Jelle v. Commissioner*[21] involved only a buy-back at net recovery value,[22] the case provides support for the IRS position on a debt write-down as well.

FOOTNOTES

1 Pub. L. No. 100-233, Sec. 615, 101 Stat. 1678 (1988), adding I.R.C. § 2001. See generally 5 Harl, *Agricultural Law* § 39.03[3][b] (2001); Harl, *Agricultural Law Manual* §§ 4.02[15][b][ii] (2001).

2 See 7 C.F.R. § 1951.909.

3 7 C.F.R. § 1951.909(e)(5). See Harl, "Handling Shared Appreciation Mortgages," 11 *Agric. L. Dig.* 1 (2000).

4 7 C.F.R. § 1951.909(h)(3).

5 7 C.F.R. § 1951.909(h).

6 116 T.C. No. 6 (2001).

7 7 C.F.R. § 1951.909(e).

8 7 C.F.R. § 1951.909(h).

9 116 T.C. No. 6 (2001).

10 *Id.*

11 *Id.*

12 *Id.*

13 *Id.*

14 *Id.*

15 See Zappo v. Comm'r, 81 T.C. 77 (1983).

16 Jelle v Comm'r, 116 T.C. No. 6 (2001).

17 *Id.*

18 Letter, Chief Counsel, Internal Revenue Service, to Farmer Program Division, Farmers Home Administration, May 22, 1989, reproduced as Appendix 39C, 5 Harl, *Agricultural Law* (2001).

19 *Id.* at 6.

20 7 C.F.R. § 1951.909.

21 116 T.C. No. 6 (2001).

22 7 C.F.R. § 1951.909(h)(3).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

ADMINISTRATIVE CLAIMS. The debtors had leased farmland from a creditor. The landlords' liens were not perfected and were avoided by the Chapter 7 trustee. However, the debtors used the farms during the bankruptcy case, planting the crops just before filing for bankruptcy and harvesting the crops 142 days later. The landlords filed administrative claims for the rental of the properties during the bankruptcy case. The Bankruptcy Court had determined the rental value of the properties by multiplying the annual rent by a fraction equal to the number of days the property was used by the bankruptcy estate divided by 365. The appellate court remanded the case because the use of the number 365 failed to take into account the limited use and lower rental value of a farm during nonproductive months. The court noted that, in this case, the bankruptcy estate had the use of the farm during nearly the entire productive period of the farm for the year, from planting to harvest. The court required the fair rental value to be determined by the usefulness of the property during the bankruptcy case. ***In re***

Agricultural Law Manual* **(ALM).

Wedermeier, 239 B.R. 794 (Bankr. 8th Cir. 1999), *aff'd*, 237 F.3d 938 (8th Cir. 2001).

SETOFF. The debtor was a wholesale distributor of food products which had contracted with a manufacturer of pickle products. The debtor placed the purchased pickle products in a warehouse for resale to retailers and the military. The debtor would bill the retailers directly and submit the proceeds to the manufacturer in payment for the pickles sold. However, when pickles were sold to the military, the manufacturer billed the military and credited the debtor's account with the sale proceeds. At the time of the bankruptcy filing, the debtor owed the manufacturer for purchased pickle products and the manufacturer had credits against the debtor's accounts from military sales. The manufacturer sought permission to offset the military sales credit against the debtor's account. The manufacturer acknowledged that setoff was not allowed under the bankruptcy rules but argued that the doctrine of recoupment allowed the debtor's account to be reduced by the military sales credit. The court held that the doctrine of recoupment was not available in this case because the debt and credit did not arise from the same transaction. The court held that the initial sale of the pickle products to the debtor was too distinct from the later sale of the products to the military. ***In re* Affiliated of Florida, Inc., 258 B.R. 495 (Bankr. M.D. Fla. 2000)**.

FEDERAL TAX-*ALM* § 13.03[7].*

AUTOMATIC STAY. The debtors filed for Chapter 13 in May 1996 and listed an unsecured IRS claim for $193. The debtors' plan was confirmed in September 1996 without objection. The debtors filed their 1996 tax return in February 1997 and claimed a refund. The IRS imposed a freeze on the debtors' tax account because the debtors were delinquent on their plan payments. The court adopted the holding of some prior cases that, upon confirmation, the estate property revested in the debtors but the estate includes all property acquired by the debtors post-confirmation; thus, the refund was estate property protected by the automatic stay. The court also held that the IRS refusal to pay the refund was a violation of the automatic stay and awarded the debtors $1000 in general damages, $12,000 in attorneys' fees and $7000 in emotional distress damages. ***In re* Holden, 258 B.R. 323 (D. Vt. 2000), *aff'g*, 236 B.R. 156 (Bankr. D. Vt. 1999)**.

SETOFF. The IRS had filed secured, unsecured priority and unsecured nonpriority tax claims in the debtor's Chapter 13 case. The debtors claimed a pre-petition tax refund as exempt and the IRS sought permission to apply the refund against the unsecured nonpriority tax claim, reducing the dischargeable tax claims. The debtor argued that the tax refund could be used to offset only the unsecured priority claims, reducing the nondischargeable tax claims. The court held that the IRS right of setoff took priority over the debtor's claim of exemption; therefore, the IRS could apply the refund against nonpriority tax claims. ***In re* Martinez, 258 B.R. 364 (Bankr. W.D. Tex. 2000)**.

The IRS had filed unsecured priority and unsecured nonpriority tax claims in the debtor's Chapter 13 case. The debtors claimed a pre-petition tax refund as exempt and the IRS sought permission to apply the refund against the unsecured nonpriority tax claim, reducing the dischargeable tax claims. The debtor argued that the tax refund could be used to offset only the unsecured priority claims, reducing the nondischargeable tax claims. The IRS argued that the right of setoff created an involuntary payment of taxes and the IRS could apply the refund as the IRS wanted. The court held that Section 522(c) excluded exempt property from liability for pre-petition taxes except nondischargeable taxes; therefore, the refund could be applied only to the priority tax claims and any remaining amount was to be returned to the debtor. This and the previous case represent the two main approaches to this issue, which is in need of resolution by the Supreme Court (or the Congress). ***In re* Pace, 257 B.R. 918 (Bankr. W.D. Mo. 2000)**.

FEDERAL AGRICULTURAL PROGRAMS

BRUCELLOSIS. The APHIS has adopted as final regulations amending the brucellosis regulations by changing South Dakota from a Class A to Class Free state. **66 Fed. Reg. 19847 (April 18, 2001)**.

COTTON. On December 7, 2000, OSHA issued a direct final rule amending its occupational health standard for Cotton Dust, *29 CFR 1910.1043*, to add cotton washed in a batch kier system to the other types of washed cotton that are partially exempt from the cotton dust standard. See 65 Fed. Reg. 76563. OSHA has stated that, because no negative comments were received, the amendment was effective April 6, 2001. **66 Fed. Reg. 18191 (April 6, 2001)**.

MEAT INSPECTION. The plaintiffs were federal meat and poultry inspectors, their union and a private organization. The plaintiffs sought to enjoin the USDA from instituting new meat inspection rules under which federal meat inspectors would no longer personally inspect the meat carcasses but would only oversee the inspection performed by employees of the meat packers. The plaintiff argued that the Federal Meat Inspection Act (FMIA), 21 U.S.C. § 604, required the federal inspectors to do the inspections. The USDA argued that the term "inspection" included observing others do the inspection but the court held that the plain meaning of the statute prohibited the USDA from allowing anyone but federal inspectors to do the inspection of processed meat. After the first appellate decision, the USDA modified the inspection procedure to have one inspector observe all carcasses and one inspector float throughout the line to oversee the other inspections. The plaintiffs argued that, although the modifications met the statutory requirements, the single inspector of the carcasses was insufficient to properly inspect the carcasses. The District Court, on remand, held that the modified rules met the statutory requirements. **American Fed. Of Employees v. Glickman, 127 F. Supp.2d 243 (D. D.C. 2001), *on rem. from*, 215 F.3d 7 (D.C. Cir. 2000)**.

POTATOES. The AMS has issued a proposed rule setting forth the terms of the Fresh Russet Potato Diversion Program for 2000. The proposed program will assist fresh Russet potato growers faced with oversupplies and low prices by diverting potatoes to charitable institutions, for livestock feed, to convert them to ethanol, and to render them nonmarketable and dispose of them in accordance with federal, state and local regulations. **66 Fed. Reg. 19099 (April 13, 2001)**.

FEDERAL ESTATE AND GIFT TAX

GIFT. The decedent's predeceased spouse had owned a corporation and served as chief executive officer. The spouse had given annual gifts of stock in the corporation to the spouse's executive assistant. After the corporation was sold, the spouse gave money instead of stock. The spouse filed gift tax returns for the amounts given to the assistant. The decedent was advised to file amended gift tax returns which would treat the gifts as compensation but the decedent refused. After the decedent's death, the advisor became the executor of the decedent's estate and filed amended gift tax returns on behalf of the estate claiming that the stock and money transfers were actually compensation for services by the assistant. The estate argued that money and property transferred to an active employee could not be a gift. The court acknowledged that the employment relationship of the donor and donee could be a factor in determining the nature of a transfer. The court denyed summary judgment for either party because the determination of a gift was dependent upon several fact issues to be determined by the trier of fact. **Estate of Powell v. United States, 2001-1 U.S. Tax Cas. (CCH) ¶ 50,327 (W.D. Va. 2001)**.

Just prior to death, the decedent wrote several checks to relatives for under $10,000 each. The checks were delivered to the donees before the decedent's death but were not paid until after the decedent's death. The court ruled that the checks were incomplete gifts at the time of the decedent's death because the gifts were revocable by the decedent's ability to stop payment on the checks. Therefore, the amount of the checks was included in the decedent's estate. **Rosano v. United States, 2001-1 U.S. Tax Cas. (CCH) ¶ 60,359 (2d Cir. 2001), *aff'g*, 67 F. Supp. 2d 113 (E.D. N.Y. 1999)**.

INSTALLMENT PAYMENT OF ESTATE TAX. The decedent owned and operated 82 residential rental properties. The decedent or the decedent's employees performed all of the management and maintenance services for the properties. The decedent also had excess cash-on-hand from the rental properties, which was the insurance proceeds paid from the loss of one property by fire. The decedent had intended to use the money to replace the destroyed unit. The IRS ruled that the decedent's interest in the rental properties was one business and was eligible for installment payment of estate tax as an interest in a closely held business. The IRS also ruled that the excess cash-on-hand was included in the value of the rental property business. **Ltr. Rul. 200114005, Dec. 15, 2000**.

MARITAL DEDUCTION. The decedent's will created an annuity trust for the surviving spouse with an annuity amount of $100,000 annually. The trust also provided for an increase in the annuity to adjust for inflation. The decedent's estate representative elected to treat the trust as QTIP and included the value of the annuity with the inflation provision in the value of the trust for marital deduction purposes. The court held that the marital deduction was limited to the amount of the trust needed to produce the annuity but that the inflation increases could not be considered because the increases were contingent upon any inflation occurring. **Estate of Sansone v. United States, 2001-1 U.S. Tax Cas. (CCH) ¶ 60,399 (C.D. Calif. 2001)**.

VALUATION. The decedent's house had been destroyed by fire and the decedent had obtained an agreement from the insurance company for the rebuilding of the original residence. The cost of rebuilding was far greater than the value of the original residence because of the historic nature of the building. At the decedent's death, the building was only 57 percent completed, although the insurance company still was obligated to pay for reconstruction if the residence was completed. The decedent's estate valued the residence, for estate tax purposes, as an incomplete building and deducted the cost of completing the reconstruction. The IRS sought to include the fair market value of the residence as completed because the estate was entitled to have the residence reconstruction completed and paid for by the insurance company. The court held that the date of death determined the point at which the estate property was to be valued; therefore, the residence was to be valued as an incomplete building with no consideration to future costs or reimbursements. The court held that the insurance company obligation was too contingent to be recognized as an asset of the estate on the decedent's date of death. **Estate of Bull v. Comm'r, T.C. Memo. 2001-92**.

FEDERAL INCOME TAXATION

LEGISLATION. The Joint Committee on Taxation on April 19 released its "General Explanation of Tax Legislation Enacted in the 106th Congress," which follows the chronological order of the tax legislation as signed into law. **JCS-2-01.**

BUSINESS EXPENSES. The taxpayer was a neurologist who owned 49 acres of rural property. The land consisted of six acres of hay fields, forest and open land. The property was also used as the taxpayer's residence. The taxpayer purchased a tractor and fuel storage tank and claimed I.R.C. § 179 expense method depreciation deduction for the equipment. The tractor was used to cut the grass and weeds along the perimeter of the property and the fuel tank held fuel for the tractor. The court held that the taxpayer was not entitled to a depreciation deduction for the tractor and tank because the equipment was not used in the taxpayer's farming business. **Solomon v. Comm'r, T.C. Summary Op. 2001-53**.

The taxpayer retired from the U.S. Air Force in 1989 as an engineer and began looking for civilian work in the same area. The taxpayer worked for a short time in 1991 but did not find permanent employment until 1999. The taxpayer claimed deductions for a home office, travel expenses and various other business expenses for 1995 and 1996 which were disallowed by the IRS. The court acknowledged that job hunting expenses were generally deductible within a reasonable period but held that expenses incurred more than three years after employment in 1991 were not reasonable or deductible. **Ellis v. Comm'r, T. C. Summary Op. 2001-52**.

The taxpayer was employed by a state as an insurance examiner. The employment contract described the taxpayer as an independent contractor, although the state withheld and paid social security taxes on the amounts paid under the contract. The taxpayer sought unemployment insurance benefits after the contract was terminated but the state unemployment insurance commission ruled that the taxpayer was an independent contractor and not entitled to unemployment insurance. The taxpayer claimed deductions for travel, meals and other expenses associated with the taxpayer's duties as an examiner. The taxpayer maintained an appointment log, credit card receipts and other receipts to substantiate the expenses; however, the court found much of the log to be unreliable because it was contradicted by the receipts. The IRS also argued that the taxpayer was not entitled to business deductions because the expenses were incurred during employment. The court held that the state unemployment insurance commission ruling that the taxpayer was an independent contractor was correct; therefore, the taxpayer was entitled to claim business expense deductions. The court disallowed the expenses claimed above those allowed by the IRS for lack of substantiation. **Goins v. Comm'r, T.C. Summary Op. 2001-55**.

COURT AWARDS AND SETTLEMENTS. The U.S. Supreme Court has denied certiorari in the following case. The taxpayer had filed a wrongful termination suit against an employer and received a judgment for back pay, front pay, and pension benefits. Under the taxpayer's legal fee arrangement with the taxpayer's lawyers, about two-thirds of the award was paid to the taxpayer's attorneys. The court held that, under Alaska law, the lien for an attorney's fees did not create a property interest in the award. The court held that the taxpayer could not exclude the attorneys' fees from income, because the attorneys did not have a property interest in the fee portion of the award. The taxpayer, however, could claim the fees as a miscellaneous deduction. See also Harl, "Handling Legal Fees in Settlements," 11 *Agric. L. Dig.* 129 (2000). **Coady v. Comm'r, 2000-1 U.S. Tax Cas. (CCH) ¶ 50,528 (9th Cir. 2000), *cert. denied*, ___ S. Ct. __ (2001)**.

The taxpayer operated an orchids growing and wholesale business. The taxpayer sprayed the orchid with a fungicide which eventually caused the loss of all plants and the closing of the business. The taxpayer sought compensation from the fungicide manufacturer which first provided assistance payments. The taxpayer sued the manufacturer for lost profits, loss of business, diminution of sales, additional business expenses, a reduction in the value of the plaintiffs' business, lost plants, and a diminution of the value of the plaintiffs' nursery as a result of contamination of the soil. The taxpayer received a jury verdict and the parties reached a settlement agreement during the appeal. The taxpayer excluded the assistance payments and the settlement from income. The Tax Court held that all payments were included in income because the assistance payments were not gifts or loans and the lawsuit involved claims for loss of property and loss of business reputation, none of which were personal injuries. The appellate court reversed and remanded, holding that any damages received for injury to the taxpayer's business reputation were excludible from income as personal injury damages. The appellate case is designated as not for publication. On remand, the Tax Court held that none of the settlement proceeds were allocable to loss of business reputation because (1) the taxpayer's attorney advised the jury that the taxpayer was not seeking compensation for loss of business reputation and (2) the settlement made no allocation of the proceeds to the loss of business reputation claim. **Henry v. Comm'r, T.C. Memo. 2001-86, *on rem. from*, 2001-1 U.S. Tax Cas. (CCH) ¶ 50,330 (11th Cir. 2001), *rev'g*, T.C. Memo. 1999-205**.

DEPRECIATION. The taxpayer operated a welding business and had claimed current deductions for three pieces of welding equipment as supplies. The IRS determined that the equipment was depreciable personal property and disallowed the deductions. The taxpayer sought to amend the tax return to claim a Section 179 expense method depreciation deduction for the equipment. The IRS argued that the Section 179 election was not allowed because the election was not made on the first return. The court held that the IRS did not abuse its discretion in refusing to allow the taxpayer to amend the tax return to include the Section 179 election. **Patton v. Comm'r, 116 T.C. No. 17 (2001)**.

DISASTER PAYMENTS. On March 28, 2001, the President determined that certain areas in Massachusetts were eligible for assistance under the Disaster Relief and Emergency Assistance Act, 42 U.S.C. § 5121, as a result of record snow fall on March 5, 2001. **FEMA-3165-EM**. On March 28, 2001, the President determined that certain areas in New Hampshire were eligible for assistance under the Act as a result of record snow fall on March 5, 2001. **FEMA-3166-EM**. Accordingly, a taxpayer who sustained a loss attributable to the disasters may deduct the loss on his or her 2000 federal income tax return.

ELECTRICITY CREDIT. The IRS has published the inflation adjustment factor and reference prices that are to be used in determining the availability of the I.R.C. § 45(a) renewable electricity production credit. These figures apply to calendar year 2001 sales of kilowatt hours of electricity produced in the United States or a possession from qualified energy resources. The inflation adjustment factor for calendar year 2001 is 1.1641, and the reference prices are 2.57 cents per kilowatt hour for facilities producing electricity from wind energy resources and zero cents per kilowatt hour for facilities producing electricity from closed loop biomass and poultry waste. The renewable electricity production credit for calendar year 2001 is 1.7 cents per kilowatt hour on the sale of electricity produced from wind, closed-loop biomass, and poultry waste energy resources.

HOBBY LOSSES. The taxpayers owned an S corporation which owned and operated a recycling business and a farm. The farm was leased from another corporation owned by the taxpayers and the S corporation leased a portion of the farm to an unrelated party under a grazing lease and used the remaining portion for livestock and almond orchards. The court held that the S corporation did not operate the farm with the intent to make a profit because (1) the corporation did not implement changes to the operations so as to make them profitable, (2) the taxpayers did not have expertise on how to operate a farm and the corporation failed to seek the advice of experts on how to make the farm profitable, (3) expenses were maximized and receipts minimized in the method of operating the farm, the corporation had high profits from the recycling business which were offset by the farm losses, (4) the losses increased each year, and (5) the taxpayer spent considerable time on the recycling business and not the farm business. **O'Connor, v. Comm'r, T.C. Memo. 2001-90**.

IRA. The taxpayer was an attorney who operated a law practice through a professional corporation. The corporation provided a defined benefit, single-employer pension plan for the taxpayer and made all of the contributions to the plan. The taxpayer received a distribution from the plan and rolled the distribution over to an IRA. The taxpayer received an early distribution from the IRA but did not include the distribution in income. The IRS assessed taxes based on including the IRA distribution in the taxpayer's income. The court held that the distribution was includible in the taxpayer's income because the taxpayer failed to provide any evidence or argument to support the failure to include the distribution in income. **Pena v. Comm'r, T.C. Memo. 2001-95**.

INNOCENT SPOUSE DEFENSE. The taxpayer was married to a person who operated a cattle-raising activity. The taxpayer helped keep the records for the activity and knew that the activity was not profitable. The taxpayer testified that the spouse and taxpayer expected the activity to become profitable. The taxpayer separated from the spouse in 1993 and the couple was divorced in 1996. The taxpayer knew the spouse continued the cattle-raising activity in 1993 but did not participate in any aspect of the activity. The IRS disallowed deductions for expenses of the cattle-raising activity for 1993 in excess of income because the IRS ruled that the activity was not engaged in for profit. The taxpayer was assessed for the tax deficiency arising from the disallowed deductions. The taxpayer sought relief from the liabilty for the taxes under the innocent spouse defense. The court held that the IRS failed to prove that the taxpayer knew that the former spouse engaged in the cattle-raising activity without an intent to make a profit. **King v. Comm'r, 116 T.C. No. 16 (2001)**.

INSTALLMENT REPORTING. The taxpayer owned a housing construction business. The taxpayer purchased land and built 58 homes on subdivided lots. The homes were sold through a third party real estate broker and the taxpayer accepted promissory notes for part of the purchase price. The taxpayer reported only the portion of the notes actually paid in each tax year, using the installment method of reporting the income from the notes. The court held that, under I.R.C. § 453(b)(2)(A), the taxpayer was not entitled to use the installment of reporting income from the notes because the taxpayer was a dealer in that the homes were held for sale to customers in the ordinary course of the taxpayer's business. **Raymond v. Comm'r, T.C. Memo. 2001-96**.

The taxpayer, a trust, owned a meat packing business which was operated by the beneficiaries' family for many years. The business had financial trouble and was sold to another company for cash and promissory note. The note provided for payments depending upon the net income of the business but also provided for full payment by a date certain. The company was later resold and the notes were modified as to the payment schedules. The taxpayers did not include the face value of the note in income for the year of the first sale. The taxpayers argued that the note had no ascertainable value in the first year as an open transaction because the payments were uncertain in that the payments depended upon the net income of the business. The court held that the open transaction rule was rarely applied because gain could be reported by the installment method of reporting. The court held that the notes had an ascertainable value in the year of sale because the business was well established and was reasonably expected to provide annual net income. **Bernice Patton Testamentary Trust v. United States, 2001 U.S. Tax Cas. (CCH) ¶ 50,332 (Fed. Cls. 2001)**.

The taxpayers owned an S corporation which manufactured, sold and leased farm irrigation equipment. The company provided financing to the buyers by taking promissory notes as part of the purchase price. The corporation reported the income from these sales on the installment method. The taxpayers agreed that dealers are not allowed the use of installment reporting of gain from the sale of personal property in the course of business. However, the taxpayers argued that the exception for farm property in I.R.C. § 453(l)(2)(A) applied to allow installment reporting because the irrigation equipment was used in farming by the purchasers. The court held that the exception applied only to farmers who sell personal property used by both the buyer and seller in a farming business; therefore, the taxpayer was not entitled by the exception to use the installment method of reporting. **Thom v. United States, 2001-1 U.S. Tax Cas. (CCH) ¶ 50,345 (D. Neb. 2001)**.

INTEREST. The IRS has ruled that interest or other fees imposed by credit card companies on tax payments made with a credit card are not deductible as interest. The IRS ruled that the interest is a personal interest expense. In addition, the IRS ruled that the prohibition of fees and charges, under Temp. Treas. Reg. § 301.6311-2T(a), for payment of taxes by credit card did not apply to credit card companies. **CCA Ltr. Rul. 200115032, Feb. 12, 2001**.

INVESTMENT INCOME. The taxpayer purchased silver coins using money borrowed specifically for the purchases. The taxpayer also owned residential rental properties which the taxpayer managed and maintained. The taxpayer sought to claim the interest paid on the silver coin purchase loans as an offset against the income from the rental properties. The court held that the income from the rental properties was not investment income because the taxpayer materially participated in that activity. The court also held that, because the taxpayer had no investment income from the silver coins or the rental properties, the investment interest from the silver coin loans was not deductible. **Ritter v. Comm'r, T.C. Summary Op. 2001-57**.

S CORPORATIONS-*ALM* § 7.02[3][c].*

TERMINATION. An S corporation was administratively dissolved by the state because the corporation failed to file an annual report. The corporation was unaware of the dissolution for some time but took the necessary steps to reincorporate as soon as the state action was discovered. The

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IRS ruled that the administrative dissolution and reincorporation did not terminate the Subchapter S election or the corporation's tax status as a corporation. **Ltr. Rul. 200114029, Jan. 8, 2001**.

SAFE HARBOR INTEREST RATES
May 2001

	Annual	Semi-annual	Quarterly	Monthly
Short-term				
AFR	4.25	4.21	4.19	4.17
110 percent AFR	4.68	4.63	4.60	4.59
120 percent AFR	5.11	5.05	5.02	5.00
Mid-term				
AFR	4.77	4.71	4.68	4.66
110 percent AFR	5.25	5.18	5.15	5.12
120 percent AFR	5.73	5.65	5.61	5.58
Long-term				
AFR	5.43	5.36	5.32	5.30
110 percent AFR	5.99	5.90	5.86	5.83
120 percent AFR	6.53	6.43	6.38	6.35

Rev. Rul. 2001-22, I.R.B. 2001-___.

TRAVEL EXPENSES. The taxpayer was self-employed in insurance sales. The business required the taxpayer to travel to other cities to meet with clients. The taxpayer maintained an appointment calendar which included the names of cities, the names of the people visited and the number of miles traveled. The court found that the listing of names was not credible evidence because the names were added after the IRS audited the taxpayer's returns. The court also discredited the mileage figures because the figures were often clearly incorrect, based on the other information in the calendar. The court held that the mileage deductions were properly disallowed by the IRS for lack of substantiation. **Marquardt v. Comm'r, T.C. Summary Op. 2001-59**.

WITHHOLDING TAXES. The taxpayer was a professional baseball team which was required to pay back wages under an employment settlement. The employees who received the payments did not work for the team in the year the back wages were paid. The Sixth Circuit Court of Appeals held that, under *Bowman v. United States, 824 F.2d 528 (6th Cir. 1987)*, the wages were taxable under the FICA and FUTA rules in effect in the years the wages were earned, not when they were paid. The Sixth Circuit case was designated as not for publication. The U.S. Supreme Court reversed, holding that the back wages were to be taxed under FICA and FUTA tax rules in effect in the year the back wages were paid and not when the wages were earned. **Cleveland Indians Baseball Co. v. United States, 2001-1 U.S. Tax Cas. (CCH) ¶ 50,341 (S. Ct. 2001), *rev'g*, 215 F.3d 1325 (6th Cir. 2000)**.

PRODUCT LIABILITY

PESTICIDE. The plaintiff purchased a pesticide for the control of weevils in stored peas. The pesticide was manufactured by the defendant. The plaintiff sought recovery for breach of express and implied warranty from statements on the package labels, and manuals and for negligent oral misrepresentations by the defendant's employees. In the first case, the court held that the breach of warranty claims were preempted by FIFRA because the claims arose from information on the product's labels. The plaintiff had plead two kinds of oral representations by the defendant's employees. The first involved statements which reiterated the information on the product label. The second set of representations involved information comparing the product to other products. The court held that the first oral representations were not actionable because they involved information on the product label and were preempted by FIFRA. However, the court held that the claim arising from the second set of oral representations involving comparison of the product to other products was not preempted by FIFRA because the comparative representations involved information not found on the label and were voluntarily made for commercial advantage. *M & H Enterprises v. Tri State Delta Chemicals, Inc., 984 S.W. 2d 175 (Mo. Ct. App. 1998).* On remand, the trial court granted summary judgment to the defendant on the negligent misrepresentation claim because the court found that no false statements were made by the defendant and that any errors in the instruction manual or label were pre-empted by FIFRA because the instructions were approved by the EPA. The appellate court affirmed. **M & H Enterprises v. Tri State Delta Chemicals, Inc., 984 S.W. 2d 175 (Mo. Ct. App. 1998)**.

The plaintiff was injured while applying wood preservative as part of the plaintiff's employment. The plaintiff sued the preservative manufacturer for negligent design, manufacture, distribution, formulation, marketing, testing and selling of the chemical. The plaintiff also alleged breach of implied and express warranties, fraudulent misrepresentation and strict liability. The court first ruled that any claim based upon label requirements would be preempted by FIFRA. The court held that the implied warranty claims were preempted because the claims were based solely on the label contents. The court denied summary judgment on the express warranty claim and required the plaintiff to set forth more explicit bases for this claim. The court noted that express warranty claims are generally not preempted by FIFRA because express warranties are voluntarily provided by the manufacturer; however, if the claim was based on statements on the label, the claim was preempted. The court gave a similar ruling to the claim of fraudulent misrepresentation because the plaintiff's pleading failed to state whether the source of the misrepresentations was the label or other statements made by the manufacturer. The court held that the strict liability claim was not preempted by FIFRA because the claim was based on design defects. **Johnson v. Monsanto Chemical Co., 129 F. Supp.2d 189 (N.D. N.Y. 2001)**.

CITATION UPDATES

Catalano v. Comm'r, 240 F.3d 842 (9th Cir. 2001), *aff'g*, T.C. Memo. 1998-447 (S corporation business expenses) see p. 47 *supra*.

Witzel v. Comm'r, 2001-1 U.S. Tax Cas. (CCH) ¶ 50,339 (7th Cir. 2001), *on rem. from*, 2001-1 U.S. Tax Cas. (CCH) ¶ 50,164 (S. Ct. 2001), *rev'g*, 200 F.3d 496 (7th Cir. 2000), *aff'g in part*, T.C. Memo. 1999-64, (discharge of indebtedness) see 11 *Agric. L. Dig.* 21.

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